

Decision 03-04-061

April 17, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to
Require California Natural Gas and
Electric Utilities to Preserve Interstate
Pipeline Capacity to California.

Rulemaking 02-06-041
(Filed June 27, 2002)

ORDER GRANTING LIMITED REHEARING OF DECISION 02-03-037**I. SUMMARY**

By this decision we grant the application for rehearing of Decision (D.) 02-07-037 filed by The Utility Reform Network (TURN) and order a limited rehearing on the issue of pre-authorization for recovery of costs by California utilities for existing capacity rights on interstate gas pipelines. D.02-07-037 is a decision in Phase 1 of Rulemaking No. 02-06-041 ("OIR"). By D.02-07-037 we established rules for California natural gas utilities and the state's largest electric utilities concerning subscription to turned back capacity on the El Paso Natural Gas Company (El Paso) interstate pipeline. (R.02-06-041 at 1.) D.02-07-037 also authorizes full recovery for existing interstate pipeline capacity rights for Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), San Diego Gas and Electric Company (SDG&E), and Southwest Gas because "they are being expected to also sign up for additional capacity rights" on the El Paso system. (D.02-07-037 at 18.)

On August 26, 2002, TURN filed an application for rehearing of D.02-07-037, alleging that the portion of the decision pre-authorizing recovery by the utilities for existing capacity rights violates sections 451, 1708 and 1757.1 and unlawfully revises D. 95-12-046, with respect to PG&E's Transwestern Pipeline Company (Transwestern) pipeline capacity rights. We have reviewed each and every one of TURN's allegations

and find that TURN's arguments regarding the procedures required under Section 1708 have merit. Accordingly, we hereby grant a limited rehearing of D.02-07-037 with respect to our authorization of PG&E's full recovery of its costs for its existing interstate pipeline capacity rights on Transwestern. This issue will be taken up in Phase 2 of this proceeding on recovery for existing interstate pipeline capacity.

II. DISCUSSION

Phase 1 of this proceeding was conducted on an emergency basis because we were "dealing with an emergency situation facing California..." as a result of a May 31, 2002 Federal Energy Regulatory Commission (FERC) order which "threaten[ed] California with the loss of up to 725 MMcfd of El Paso capacity as early as July 31, 2002." (D.02-07-037 at 5 and 13.) The OIR instructed the parties that we were considering adoption of two rules concerning turned back capacity on the El Paso interstate gas pipeline and that comments on the proposed rules were due on an expedited basis. The issue of recovery of existing interstate pipeline capacity rights was initially raised in comments on the OIR filed by PG&E, SoCalGas, SDG&E and Southwest Gas.

D.02-07-037 adopted the two rules set forth in the OIR:

The first rule requires the natural gas and large electric utilities to sign up for proportionate amounts of El Paso turned back capacity at specified delivery points to the extent that California replacement shippers do not sign up for the turned back capacity, and the second rule finds just and reasonable the California utilities' subscription to this turned back capacity, as well as their existing capacity rights on interstate pipelines. (*Id.*, at 1.)

Because the purpose of these rules is to preserve California's interstate pipeline capacity to avoid any future gas shortages (and potential energy crisis), we granted the utilities' request for pre-authorization of existing capacity rights. (See D.02-07-037 at 27, Ordering Paragraph No. 3.) Given the public interest in preserving pipeline capacity, we determined:

...[U]nder current market conditions and in light of the benefits to California of utility retention of existing interstate pipeline capacity rights, it is just and reasonable for the California utilities to keep their existing capacity rights and perform short-term capacity releases when they do not need to utilize all of their capacity rights. Therefore, we find that to the extent the California utilities comply with our new rules, they should also be compensated in full by their ratepayers for the costs of their existing capacity rights on interstate pipelines. (*Id.*, at 19.)

TURN objected to the proposal for pre-authorization of existing pipeline capacity costs in its reply comments on the OIR. In response to PG&E's request for pre-authorization for recovery of its costs of its existing capacity on the Transwestern pipeline, TURN raised D.95-12-046¹ and claimed that PG&E was attempting to use this rulemaking to evade the results of that decision and that such action would likely violate Public Utilities Code section 1708.² Although TURN did raise section 1708, it did not specifically state a hearing was required or request a hearing.

TURN contends that the decision's outcome modified D.95-12-046 without application of the required procedural safeguards as set forth in section 1708, which require the Commission to provide notice and hearing before it changes a prior decision. Section 1708 provides:

The [C]ommission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or

¹ D.95-12-046 was issued in Application No. 93-04-011, "Application of Pacific Gas and Electric Company for Commission Order finding the Gas and Electric Operations During the Reasonableness Review Period from January 1, 1992 to December 31, 1992 were prudent." By that decision, the Commission denied PG&E recovery of its Transwestern costs in 1992 and in all future years, absent certain information. However, in D.97-08-055, the Commission subsequently approved a settlement involving PG&E's Core Procurement Incentive Mechanism (CPIM), which allowed PG&E's recovery of Transwestern capacity costs when PG&E used the Transwestern capacity to transport natural gas PG&E had procured.

² All statutory references are to the Public Utilities Code unless otherwise indicated.

decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision.

The primary issue in D.95-12-046 was “PG&E’s 15-year commitment to interstate pipeline capacity on the Transwestern Pipeline Company (Transwestern) expansions that became operational in March 1992.” (D.95-12-046 at 2.) That 15-year period is still in effect.

By D.95-12-046 the Commission explicitly concluded:

PG&E shall be denied recovery of all Transwestern subscription costs in 1993 and subsequent years unless it establishes in a reasonableness filing that the customers to whom it would allocate these costs have received, or will receive, benefits directly attributable to the subscription that outweigh the requested recovery. (*Id.*, at 61, Ordering Paragraph No. 3.)

By Ordering Paragraph No. 4 of D.95-12-046 the Commission further held that “[a]ny filing made for cost recovery [by PG&E] shall meet the meet the minimum filing requirements set forth in Conclusion of Law [No.] 5.” (*Id.*) The Commission disallowed PG&E recovery of the subscription costs for Transwestern in 1992 and in each subsequent year of the 15-year contract as well, unless PG&E, in any subsequent filing seeking to recover Transwestern costs, could meet the minimum requirements set forth at pages 52-53 and Conclusion of Law No. 5 of D.95-12-046. (*Id.*, at 2-3, and 52.) By its filed comments in this proceeding, PG&E neither referenced D.95-12-046 nor produced any of the information required by it “for cost recovery ... [in] subsequent years.”

In raising the Transwestern recovery issue in this proceeding, PG&E stated:

... PG&E shareholders currently are at risk for recovery of the costs of PG&E’s Transwestern capacity. PG&E pays Transwestern approximately \$21 million per year in reservation charges. PG&E recovers its gas costs and pipeline charges through a “Core Procurement Incentive Mechanism” (“CPIM”). Under the existing CPIM, PG&E

shareholders are at risk for PG&E's Transwestern capacity costs whenever that capacity is not being "sequenced" to serve core customers. PG&E shareholders are required to absorb, at their loss, any Transwestern charges that PG&E does not recover when it releases the capacity to the secondary market. Ironically, therefore, the Transwestern capacity represents a liability to shareholders, even as it provides significant benefits to PG&E's core customers. PG&E asks that the Commission, in its final rulemaking order in this case calling for incremental subscription to El Paso capacity, simultaneously endorse the proposition that PG&E's Transwestern capacity should be given the same treatment the Commission proposes for such El Paso capacity. ... [E]xisting capacity on Transwestern—should now be deemed ... just and reasonable, and should be entitled to the same full cost recovery. (7/8/02 PG&E Opening Comments, at 10-11.)

PG&E's footnote No. 3 at page 11 of its Opening Comments states:

PG&E is not asking the Commission at this time to consider or approve detailed changes to the CPIM. Rather, all PG&E seeks in the upcoming July 17 [2002] order is a policy declaration that the Transwestern costs are fully recoverable. The details of such recovery, such as a CPIM modification, can then be resolved through subsequent proceedings in Phase 2 of this case. (*Id.*)

The outcome sought by this request is in conflict with the requirements of D.95-12-046. (D.95-12-056 at 52-53, and 61, Ordering Paragraph No. 3.)

By permitting full recovery of PG&E's Transwestern subscription costs in the event the PG&E complies with the adopted rules and without any requirement that the utility comply with D.95-12-046, we have inadvertently modified the earlier Commission decision regarding recovery of Transwestern costs.

TURN argues that there was not requisite notice to modify D.95-12-046 because the OIR did not mention the Transwestern costs or other existing capacity costs. Further, TURN argues that we specifically limited Phase 1 of the proceeding to a consideration of the two proposed rules—both of which are unrelated to existing capacity

holdings. In addition, TURN contends, the OIR is silent on the issue of existing capacity rights, and is solely related to El Paso turn back capacity. TURN did receive notice of the OIR; the core question is whether it had adequate notice that the justness and reasonableness of existing capacity rights was within the scope of the OIR and was at issue in Phase I. TURN asserts it did not.

PG&E, in its response to TURN's application for rehearing, contends that the issue of existing capacity rights was "naturally" raised in the title of the OIR, and that therefore TURN had notice. PG&E argues that its opening comments, in which it raises recovery of its existing Transwestern capacity costs, provides notice of and rationale for the issue, in satisfaction of section 1708.³

Yet we recognize that it is the Commission, not a party in a proceeding, that is required by statute to notify the public and provide it with an opportunity to be heard as in the case of complaints, prior to our modifying any decision. (§ 1708; see also, *California Trucking Assn. v. Public Utilities Comm.* (1977) 19 Cal.3d 240.) If D.02-07-037 indeed modified D.95-12-046 was TURN provided the requisite notice and opportunity to be heard?

We must answer this with a negative. Neither the text of the OIR or the proposed rules reference existing capacity rights or D.95-12-046. While it is true that the title of the OIR does concern preservation of interstate pipeline capacity to California, the text of the document and our proposed rules are focused entirely on turned back capacity on the El Paso system.

This ...OIR is issued in response to the May 31, 2002 ...
FERC order authorizing marketers currently serving
California may turn back up to 725 million cubic feet per day
(MMcf/d) of firm capacity on the El Paso Natural Gas

³ PG&E's argument that the Transwestern costs are implicitly raised by the OIR belies its opening comments wherein it stated: "PG&E is also very concerned about the OIR's failure to address cost recovery of *existing* utility pipeline subscriptions, in particular PG&E's Transwestern capacity." (PG&E Opening Comments, dated July 8, 2002, at 9.)

Company ...interstate pipeline to El Paso's East of California (EOC) customers." (R.02-06-041 at 1.)

The scope of Phase 1 of the OIR proceeding was specifically "to adopt rules by which the designated utilities are each required to sign up for a proportionate amount of turned back capacity that is not subscribed to by other replacement shippers serving California." (*Id.*, at 9-10.) The OIR further provides:

As a corollary to this proposal, the Commission finds just and reasonable and pre-approves the California utilities subscribing to this turned back capacity. All other related issues ... will be addressed in a later phase of this proceeding. (*Id.*, at 10.)

The OIR does not explicitly reference Transwestern or any other existing capacity rights.

The Transwestern costs are not turned back capacity costs.⁴ Based on the actual language used in the OIR, it does not appear that TURN was notified by the OIR that existing capacity costs were at issue. The OIR fails to provide notice that existing costs would be considered in this proceeding, and specifically nothing in the OIR explicitly suggests anything other than turned back capacity on the El Paso system would be at issue in Phase I of this proceeding. Moreover, even if the OIR implicitly raises the issue of reasonableness of existing capacity rights, the OIR clearly did not contemplate holding an evidentiary hearing in Phase 1—something that is required under section 1708 if indeed the intent of the OIR was to modify a previous Commission decision regarding the justness and reasonableness of existing capacity rights, such as D.95-12-046, as TURN claims the decision has done.

TURN contends there was no emergency basis for reaching an expedited decision on the issue of Transwestern cost recovery. TURN argues that if our policy in finding the existing pipeline capacity to be just and reasonable lies in retaining existing pipeline capacity and thus meeting the overall goal of adequate pipeline capacity for

⁴ Appendix A of the OIR provides definitions of various terms used in the OIR and it is clear that El Paso refers solely to El Paso Natural Gas Company interstate natural gas pipeline. The term "turned back capacity" refers to "the up to 725 MMcf/d of El Paso firm capacity rights...."

California, then the issue of cost recovery for existing capacity is a separate issue that lacks any emergency time pressure associated with the El Paso turned back capacity. By TURN's logic, pre-authorization of cost recovery for El Paso turned back capacity permits the utilities to bid immediately for such capacity which may otherwise be lost. TURN contends that no such immediate finding was required to preserve PG&E's existing capacity on the Transwestern system.

The OIR's timetable was based on the FERC May 31, 2002 Order and our duty to ensure that a significant portion of El Paso's capacity to California was not lost. Thus, we adopted the rules in an emergency context in an attempt "to preserve as much as possible of the existing infrastructure that has historically served California." (D.02-07-037 at 21.) While preservation of existing capacity could arguably arise from the Phase 1 issues, whether existing capacity cost recovery would be pursued in Phase 1 is the point TURN successfully urges.

TURN further argues that by D.95-12-046, PG&E was explicitly required to use economic data to "conclusively demonstrate that direct benefits flowed to the customers that outweigh the subscription costs it seeks to allocate to them." (TURN application for rehearing at 9, quoting from D.95-12-046.) D.95-12-046 specified that PG&E's Transwestern costs for each year of the 15-year contract must be disallowed unless PG&E can establish the benefits as set forth in D.95-12-046. TURN contends that D.02-07-037 has no basis for finding those costs to now be just and reasonable, and that without relying on the information required by D.95-12-046 our finding is a violation of section 451's requirement that all charges shall be just and reasonable.

Public Utilities Code section 451 provides in part:

All charges demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

TURN argues that “[a]ny credible analysis of the net benefits of the Transwestern capacity would have to consider the data on actual utilization and cost of the [Transwestern] capacity.” (TURN application for rehearing at 10.) TURN further argues that the record is void of any such information and thus, we could not conclude that Transwestern capacity provides net benefits to ratepayers.

Whether or not TURN’s argument regarding what it believes may constitute a credible analysis is accurate, TURN has accurately demonstrated that there is no evidence in the record concerning PG&E’s actual Transwestern capacity costs, nor was any evidence presented to date of the type specified in D.95-12-046. Although D.95-12-046 found the Transwestern costs to be unjust and unreasonable, it did provide PG&E with the opportunity to establish such costs are just and reasonable in future filings. PG&E’s filed comments seeking full funding for the Transwestern subscription costs did not take advantage of the opportunity offered by D.95-12-046.

We thus conclude TURN’s allegations, which concern the procedural requirements that must be followed for PG&E’s full recovery of Transwestern capacity costs, have merit. Therefore, a limited rehearing is granted and shall be held in Phase 2 of this proceeding. We shall hereby expand the scope of Phase 2 to include recovery by the California utilities of existing gas transmission subscription costs. We hereby direct the presiding Administrative Law Judge (ALJ) to issue a revised schedule and scoping memorandum seeking comments by the parties on this issue, including discussions of relevant law, procedure, and whether a hearing is necessary and if so, a proposed hearing schedule. All parties may file comments on the issue no later than the date to be set by the presiding ALJ in a subsequent ruling. However, PG&E in particular, shall brief the Commission on the requirements set forth in D.95-12-046 and provide evidence concerning these requirements. PG&E may also brief the Commission on whether the Commission should modify that decision. By this order, the Commission is providing notice to the parties that in phase 2, the Commission may modify the requirements set forth in D.95-12-046 to the extent that they were not already modified by the adoption of the CPIM settlement in D.97-08-055. The presiding ALJ shall, within 30 days after the

date comments are to be filed, issue a ruling concerning how existing transmission costs will be handled in this proceeding. Nothing in this Order Granting Limited Rehearing of Decision 02-03-037 modifies the requirements, which already exist in Ordering Paragraphs 2, 3, and 4 of and Rules B. and C. attached to Decision 02-07-037 and which require the California utilities to sign up for as much El Paso turned back capacity as possible, prohibit them from entering into long-term capacity release transactions and provide them with full compensation in their rates for the costs associated with their subscription to the turned back capacity to the extent that they comply with these requirements.

III. CONCLUSION

TURN has demonstrated legal error in Decision 02-07-037 and limited rehearing, as set forth herein, should be granted.

Therefore, **IT IS ORDERED** that:

1. A limited rehearing of Decision 02-07-037 is granted.
2. The rehearing shall be held in a later phase of this proceeding.
3. The Presiding Administrative Law Judge shall, within 10 business days from the effective date of this decision, issue a ruling setting forth a revised schedule and scoping memorandum for Phase 2 of this proceeding and setting a date for comments by the parties on the issue of recovery by the utilities of existing gas transmission subscription costs. Filed comments shall include a discussion of relevant law, procedure, and whether a hearing is necessary on this issue and if so, a proposed hearing schedule.
4. If PG&E seeks full recovery of existing transmission costs, including its Transwestern subscription costs, it shall, include in its filed comments a discussion of the requirements set forth in Decision 95-12-046 and formally advise the Commission whether it is seeking a modification of that decision. Other parties may file comments on this issue.

5. This order is effective today.

Dated April 17, 2003, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners

I will file a concurrence.

/s/ LORETTA M. LYNCH
Commissioner

/s/ SUSAN P. KENNEDY
Commissioner

CONCURRING OPINION of Commissioner Loretta M. Lynch and Commissioner Susan P. Kennedy:

In July last year, the Commission directed the utilities to bid for and acquire as much El Paso capacity to California as possible. At the time, the Commission recognized that, after the extreme price spikes of the 2000-2001 winter, the world has changed and protecting firm interstate capacity to the California border is one of the cheapest forms of insurance against future price spikes that California can buy. Conditions in today's natural gas market that lead us to initiate this rulemaking have not changed since last summer. Thus, it is more important than ever that we preserve what interstate capacity we can to the Southwest producing basin, and PG&E's Transwestern capacity is an important part of that total capacity.

We support this order on rehearing, because it appears clear that legal error was committed in the underlying decision. PG&E should not be unduly concerned about our grant of rehearing. Today's order finds that procedural errors were committed, and provides that the issue of recoverability of PG&E's capacity costs on the Transwestern pipeline shall be taken up promptly in Phase 2 of the proceeding, which is ongoing. In the Phase 2 proceeding, the procedural infirmities can be corrected, and PG&E will have the opportunity to make the evidentiary showing required by our 1995 decision on the Transwestern issue, D.95-12-046. PG&E will also have the opportunity to present any evidence and argument that it may have that the 1995 rules should be changed. In order to resolve this uncertainty, we intend to insure that the Transwestern issue is taken up promptly and addressed in a manner which is fair to all interested parties.

There are two final points we wish to emphasize. First, among the reasons that rehearing is being granted is the fact that in demanding recovery of its Transwestern costs in this proceeding, PG&E failed even to identify or discuss our 1995 decision that requires PG&E to make a specific evidentiary showing in order to recover those costs, much less attempt to make the required evidentiary showing. This type of advocacy borders on deception, and undermines PG&E's position. Second, PG&E has recently threatened to refuse to renew El Paso capacity that it acquired in response to D.02-07-037 unless rehearing on the Transwestern capacity costs is denied. Such a refusal would be in direct conflict with the clear requirement in D.02-07-037 that PG&E sign up for as much El Paso turned back capacity as possible. While PG&E has the right to vigorously advocate for its positions, violating or threatening to violate this Commission's orders are not legitimate tools in the utility's toolbox.

Dated April 17, 2003, San Francisco, California.

/s/ LORETTA M. LYNCH
LORETTA M. LYNCH
Commissioner

/s/ SUSAN P. KENNEDY
SUSAN P. KENNEDY
Commissioner